

**State of Montana**

**REPORT TO THE LEGISLATURE**

**Sunset Audit**

**BOARD OF MILK CONTROL**

The 1977 Sunset Law terminates the Board on July 1, 1983. This review provides information to assist the Legislature in making the decision to continue or modify the Board.

This report presents eleven areas for legislative consideration (page 24) including:

- ▶ Wholesale, retail, and producer price controls.
- ▶ Uniform producer prices.
- ▶ Regulatory structure.
- ▶ Butterfat testing.

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STATE OF MONTANA

Office of the Legislative Auditor



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September 1982


The Legislative Audit Committee  
of the Montana State Legislature:

This is our sunset performance review of the Montana Board of Milk Control. The review was conducted in response to the 1977 Sunset Law, which terminates the board on July 1, 1983.


There are no formal recommendations in the report since the responsibility for such recommendations lies with the Audit Committee. Nevertheless, we discussed the contents of the report with a number of individuals and organizations, including the director of the Department of Commerce, the members of the board, the Department of Livestock, and the Montana Dairymen's Association.

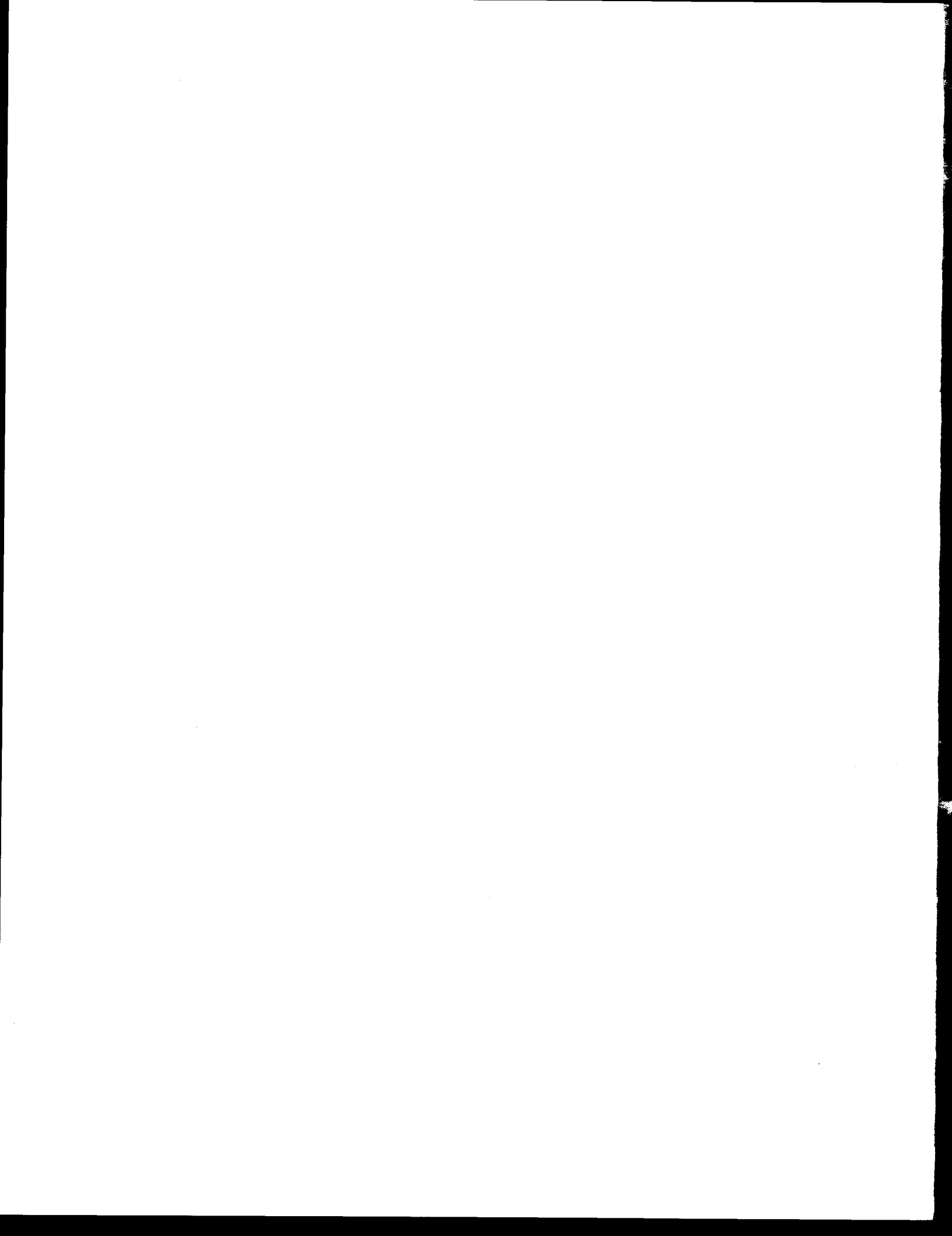
We wish to express our appreciation to the members of the board and to the director of the department and his staff for the assistance they provided during the review. We also wish to thank the members of the milk industry.

Respectfully submitted,

  
Scott A. Seacat  
Principal Audit Manager  
Sunset and Performance Audits

Approved:

  
Robert R. Ringwood  
Legislative Auditor



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APPOINTIVE AND ADMINISTRATIVE OFFICIALS

BOARD OF MILK CONTROL

Curtis Cook	Hamilton	1983
Kenneth Mortag	Cascade	1985
Bobbye Johnson	Miles City	1985
Rae Haas	Helena	1983
Evelyn Itcaina	Dodson	1985

DEPARTMENT OF COMMERCE

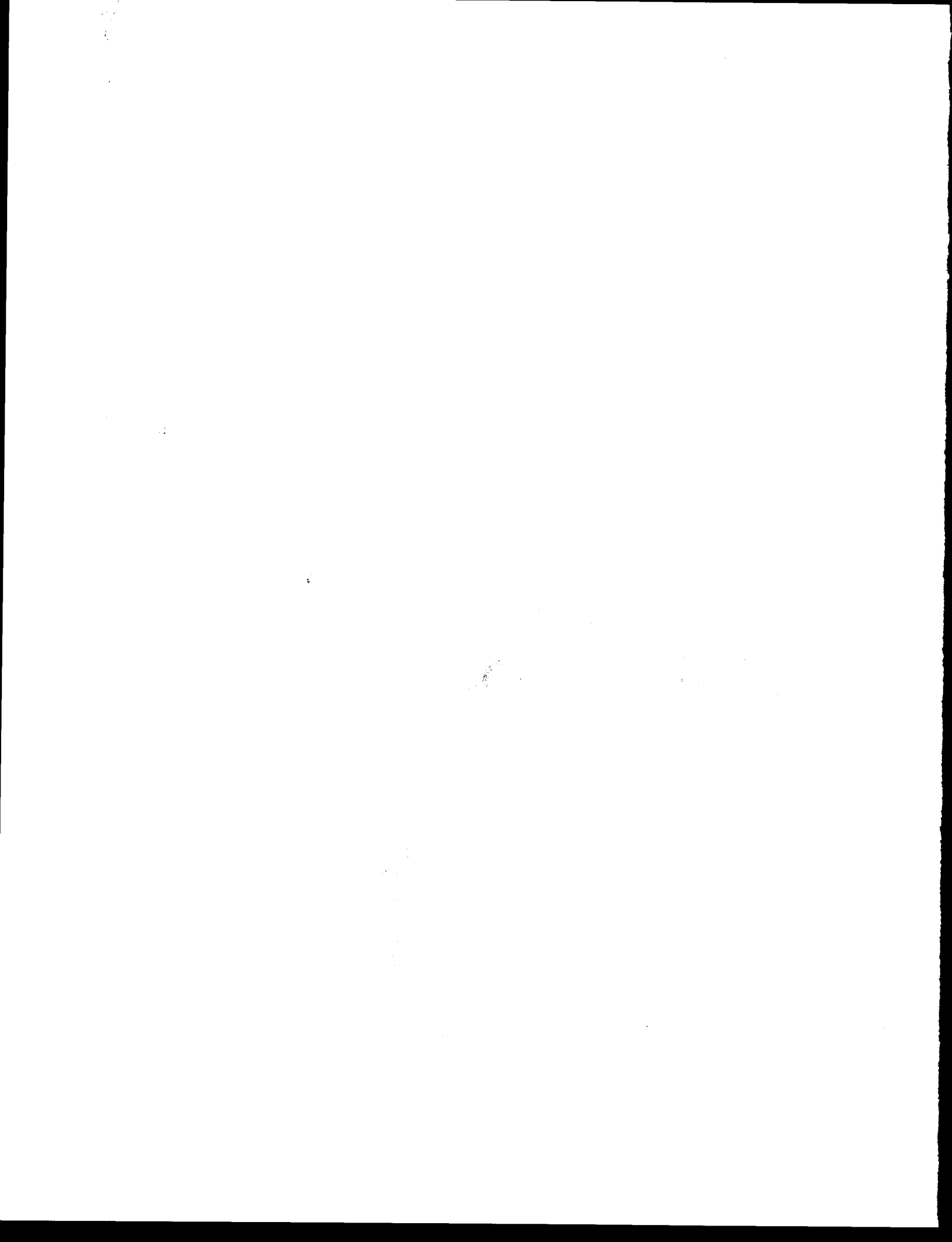
Gary Buchanan	Director
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DIVISION OF BUSINESS AND PROFESSIONAL LICENSING

Isabelle Pistelak	Administrator
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MILK CONTROL BUREAU

William Ross	Bureau Chief
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## Chapter I

### BACKGROUND

This sunset review addresses state regulation of milk prices by the Board of Milk Control, a state board administratively attached to the Department of Commerce.

### REPORT OBJECTIVES

The 1977 Legislature passed a law terminating numerous regulatory boards and agencies, including the Board of Milk Control. This law, commonly referred to as the "sunset law," requires the Legislative Audit Committee to conduct a performance review of each terminated agency. The performance review must objectively examine the need for each regulatory board/agency and the Audit Committee must offer recommendations for reestablishment, modification, or termination.

The sunset law also requires an examination of the following questions during the conduct of the committee's review:

- (a) Would the absence of regulation significantly harm or endanger the public's health, safety, or welfare?
- (b) Is there a reasonable relationship between the exercise of the state's police power and the protection of the public's health, safety, and welfare?
- (c) Is there another less restrictive method of regulation available which could adequately protect the public?
- (d) Does the regulation have the effect of directly or indirectly increasing the costs of any goods or services involved and, if so, to what degree?
- (e) Is the increase in cost more harmful to the public than the harm which could result from the absence of regulation?
- (f) Are all facets of the regulatory process designed solely for the purpose of, and have as their primary effect, the protection of the public?

Using the information contained in this report, and that gathered during a public hearing, the committee will address these six questions. During the hearing process, testimony and comments will be heard from the board/agency, the industry, and interested members of the public.

In defining legislative intent, the sunset law states that, by requiring periodic evaluation in the form of a performance review, the legislature will be in a better position to ensure that agencies and their programs exist only to be responsive to state residents' needs. The sunset law terminates the Board of Milk Control on July 1, 1983.

#### MILK INDUSTRY

Milk is classified in two ways: 1) sanitation standards and 2) use. Milk is classified as grade A or B depending on required sanitation standards. Grade A milk must meet higher standards necessary for drinking. Grade B milk may be used for manufactured dairy products.

Milk is also classified according to its use. Class I milk includes drinking milk, chocolate milk, cream, and half and half. Class II milk products are ice cream, sour cream, yogurt, cottage cheese, and dips. Class III products are cheese and butter.

The state licenses producers, distributors, producer-distributors, jobbers, and milk haulers. The producers manage dairy herds. The firms which process milk are called distributors. Dairymen who both produce and process milk are called producer-distributors. Jobbers purchase milk from the distributors for resale to retailers,

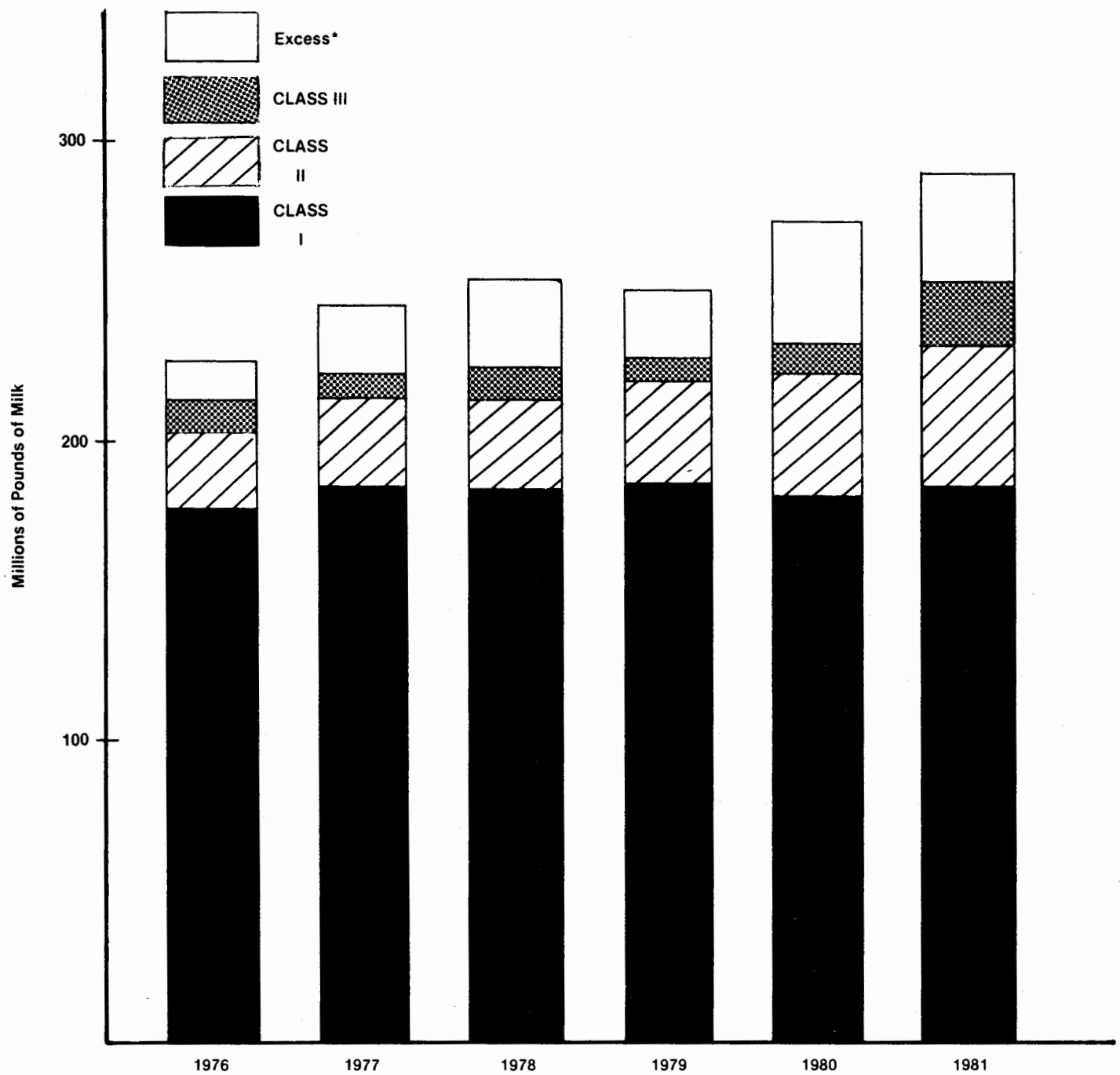
home delivery customers, schools, or other customers. The milk haulers transport milk from the producers to the distributors or between distributors.

Montana is a net exporter of milk products. Montana dairymen produced 290 million pounds of grade A milk and 6 million pounds of grade B milk in 1981. Montana consumers used about 246 million pounds of dairy products made from grade A and B milk. Of this, 187 million pounds were class I products which come exclusively from grade A milk.

Grade A milk production represents \$37 million in gross income to about 300 Montana dairy farmers. The processing, distribution, and retailing of milk also contribute to Montana's economy. There are twelve grade A processing plants which handle most of the state's production. The number of milk retailers is not exactly known, but numbers in the hundreds.

The following illustration shows the trend for the last six years of milk production and usage in Montana. Excess grade A milk is usually exported either as drinking milk or for making cheese, butter, cottage cheese, and other dairy products.

# SUMMARY OF GRADE A MILK PRODUCTION AND DAIRY PRODUCT SALES IN MONTANA (1976 to 1981)



\*Amount of Montana Grade A production in excess of total Montana dairy product sales.

Source: Compiled by the Office of the Legislative Auditor  
from Milk Control Bureau records.

Illustration I

## Chapter II

### BOARD OF MILK CONTROL

#### INTRODUCTION

The Board of Milk Control was created by the Montana Legislature in 1935, as a temporary measure, to meet emergency conditions within the state's milk industry. The act's purpose was to protect the public welfare by eliminating unfair trade practices. A board was created to regulate and control the distribution and sale of milk and to fix minimum prices. Originally, the board was composed of three members representing the Livestock Sanitary Board, the Department of Agriculture, and the public. In 1939, the Legislature created a permanent board. The board's authority was expanded and board membership was changed to five members who represented the Livestock Sanitary Board, producers, producer-distributors, distributors, and consumers.

In 1959, the Legislature significantly changed the board's composition. The legislation required that no board members could be connected in any way with production, distribution, or sale of milk or dairy products. Since that time the board has continued to be composed of public members.

In 1971, under executive reorganization, the board was administratively attached to the Department of Business Regulation. In 1981, the Legislature transferred the board and the Milk Control Bureau to the Department of Commerce.

## BOARD OPERATIONS

### Structure

The Governor appoints the five public members to the quasi-judicial board (one who must be an attorney) and designates the chairman. The Senate confirms the members of the board. The board normally meets about six times per year. Board members receive \$25 per diem plus travel expenses while participating in board business.

### Staffing

The board is attached to the Department of Commerce for administrative purposes only. The department, through the Milk Control Bureau, provides secretarial, legal, budgetary, and accounting services. The department currently allocates eight full-time staff positions to the bureau, including a bureau chief, one audit supervisor, one statistical clerk, four auditors, and one administrative secretary.

The board remains autonomous in making decisions concerning hauling rates, base and quota plans, and minimum prices. The bureau performs all aspects of licensing and enforcement relating to administration of the milk control laws.

### Funding

The board and bureau are completely financed from an account in the earmarked revenue fund. The revenue is collected from fees assessed per hundredweight on the total volume of all milk sold by producers, producer-distributors, and distributors. Montana law requires the department to set the assessment commensurate with the cost of administering the Milk Control law.



The following assessments are levied upon the licensees:

- (a) Eight cents (\$0.08) per hundredweight on all milk subject to the Milk Control Act produced and sold by a producer-distributor.
- (b) Eight cents (\$0.08) per hundredweight on all milk subject to the Milk Control Act sold in this state by a distributor home based in another state. The fee is to be paid either by the foreign distributor or his jobber who imports such milk for sale within this state.
- (c) Four cents (\$0.04) per hundredweight on all milk subject to the Milk Control Act sold by a producer.
- (d) Four cents (\$0.04) per hundredweight on milk subject to the Milk Control Act sold by a distributor, excepting that which is sold to another distributor.

The following illustration shows the board's financial history for the past seven fiscal years.

#### BOARD FINANCES

<u>Fiscal Year</u>	<u>Revenues</u>	<u>Expenditures</u>	<u>Fund Balance</u>
1981-82	\$260,727	\$242,162	\$174,632
1980-81	254,009	247,576	156,067
1979-80	248,462	245,035	149,634
1978-79	270,476	220,565	146,207
1977-78	248,768	220,407	96,296
1976-77	213,314	175,537	67,935
1975-76	184,043	172,513	30,158

Source: Montana Financial Reports

#### Illustration 2

#### BOARD GOAL AND OBJECTIVES

The sunset law requires each board under review to define its goals and objectives. The board states its goal and objectives as follows:

## GOAL:

To regulate the milk industry in such a manner that all residents of Montana will have an adequate supply of healthful milk, free from contamination, of proper physical and chemical content, and at the lowest possible cost.

## OBJECTIVES:

1. Establish a stable market for the production and sale of milk.
2. Promote the intelligent production and orderly marketing of milk and milk products.
3. Eliminate speculation and waste.
4. Make the distribution between the producer and consumer as direct as can be effectively and economically accomplished.

## BOARD AND DEPARTMENT FUNCTIONS

The board's functions include:

- setting minimum prices;
- setting hauling rates for milk transportation; and
- establishing base and quota plans.

The department is responsible for:

- auditing distributor payments to producers;
- licensing individuals and corporations engaged in milk production and processing;
- enforcing laws concerning fair trade practices; and
- receiving complaints and performing enforcement activities.

### Price-Setting

The board fixes the minimum producer, wholesale, institutional, jobber, and retail prices for Class I milk and minimum producer prices only for Class II and Class III milk.

Producer prices are established by means of a formula that provides for automatic price adjustments. The formula indexes Class I producer prices to the November 1969 Class I price. The producer price formula includes such factors as unemployment rates, wages, prices paid by farmers, and prices received by farmers. (Appendix I shows the current values, the indexed values, and the weights assigned to each factor.) The index total is then compared with a chart of prices (see also Appendix I). The formula increases or decreases the Class I price \$.23 per hundredweight for every 4.5 points change in the total index. Each change of \$.23 per hundredweight at the producer level is passed through as a \$.01 per half gallon change at the wholesale and retail levels. Using the formula, the July 1982 minimum producer price for Class I milk was calculated at \$14.01 per hundredweight. This translates to a producer's share on a half gallon of whole milk of \$.60 out of the July 1982 retail price of \$1.23 per half gallon.

Class II and III producer prices are determined through the use of average prices for nonfat dry milk and butter in the Chicago market.

Illustration 3 shows the July 1982 minimum producer prices for 100 pounds of milk.

MINIMUM PRODUCER PRICES  
(July 1982)

<u>Class</u>	<u>Price Per Hundredweight</u>
I	\$14.01
II	12.75
III	10.87

Source: Milk Control Bureau

Illustration 3

Minimum wholesale and retail prices for class I milk are also fixed by the board. The board uses a separate formula to establish minimum prices at the wholesale, retail, jobber, and institutional levels. The formula indexes the wholesale price to the November 1969 wholesale price. The factors in the formula include wages, prices paid by distributors, and wholesale prices in general. (Appendix II shows the formula's factors, the weights assigned to each factor, and the current index.) The index is compared with a chart of prices (see also Appendix II). Using the chart, the wholesaler's share for July 1982 is \$.52 per half gallon. The chart price increases or decreases \$.01 per half gallon for each 5.3 points change in the index. The wholesale price is the producer's share plus the wholesaler's share (i.e., \$.60 plus \$.52 or \$1.12). The retail price is calculated by using the wholesale price plus 10 percent per half gallon (i.e., \$1.12 plus \$.11 or \$1.23). The following illustration summarizes the producer's, wholesaler's, and retailer's shares and the resulting wholesale and retail prices.

DISTRIBUTION OF MILK PRICE  
FOR A HALF GALLON OF WHOLE MILK  
(July 1982)

<u>Level</u>	<u>Price</u>
Producer's Share	\$ .60
Wholesaler's Share	.52
Wholesale Price	\$1.12
Retailer's Share	.11
Retail Price	\$1.23

Source: Compiled by the Office of the Legislative Auditor

Illustration 4

By rule, jobber prices are computed using the producer price plus a percentage of the producer-to-wholesaler margin at an average of approximately 78 percent of the wholesale price. The percentage varies by product and size. The institutional price is computed by using 92 percent of the wholesale price.

#### Hauling Rates

A second function of the board is to regulate transportation rates which distributors, contract haulers, and others charge producers for farm-to-plant and interplant transportation of milk. The board regulates rates since the producer must pay the handling charges. The following rules apply to current hauling regulations:

1. Farm-to-plant haulers must maintain records of hauling costs by specific truck.
2. Producer routes to establish hauling costs from farm-to-plant must be submitted to and approved by the board's executive secretary.
3. Such hauling costs are determined by an audit of distributor or hauler cost records.
4. The hauler negotiates the cost of a route with the producer.
5. If no agreement can be reached between haulers and producers, the board will set rates to be paid by each producer.
6. Freight allowance for interplant transfer of primarily Class I milk range from 25¢ per hundredweight for a distance of 25 to 50 miles to 95¢ per hundredweight for a distance of 301 to 350 miles.

#### Base and Quota Plans

The board's third function is to establish base and quota plans when necessary. The board may establish base or quota plans upon petition of a distributor or the majority of his producers.

Base plans give preference to established producers by allocating to those producers the Class I usage and, therefore, higher prices. Quota plans limit the amount of production which the producer may sell to the plant. There are two active base plans (in Missoula and Kalispell) and no active quota plans in the state.

#### Audit Function

One of the major functions of the bureau is to audit distributor payments to producers. The bureau's staff of four auditors audits the books and records of each distributor every two or three months to verify the utilization of and the payment for all milk since the previous audit. The audit function is to provide an on-going review of distributor operations and a means to assure correct producer payment. When incorrect payments are identified, the bureau requests the distributor to make adjustments. Illustration 5 shows producer underpayments identified by the bureau for the years 1978 to 1981. Underpayments represent less than one percent of total payments.

<u>Distributor</u>	<u>UNDERPAYMENTS IDENTIFIED</u>				
	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>Total</u>
A	\$ 4,427	\$ 926	\$ 2,773	\$ 3,509	\$ 11,635
B	7,688	1,812	17,045	13,952	40,497
C	6,165	25,351	6,719	9,403	47,638
D	9,834	5,383	1,756	7,927	24,900
E	318	4,391	874	5,931	11,514
F	20,833	1,465	13,265	32,227	67,790
G	88,689	48,993	1,182	24,056	162,920
H	-0-	40	-0-	565	605
I	-0-	1,084	-0-	-0-	1,084
K	2,482	16,414	7,390	240	26,526
L	682	2,107	4,514	3,791	11,094
M	709	1,860	3,260	13,867	19,696
N	543	46,338	-0-	-0-	46,881
	<u>\$142,370</u>	<u>\$156,164</u>	<u>\$58,778</u>	<u>\$115,468</u>	<u>\$472,780</u>

Source: Milk Control Bureau records

Illustration 5

### Licensing

A second function of the Milk Control Bureau is licensing all producers, producer-distributors, distributors, and jobbers in the state. An annual license fee of \$2 is charged by the bureau and must be paid before July 1. These fees are deposited to the credit of the general fund. Before engaging in the business of producing or selling milk in Montana, a person must also obtain a license from the Department of Livestock. The following illustration indicates the number and types of licenses issued by the bureau for the past six fiscal years.

#### LICENSE STATISTICS

<u>Type of License</u>	<u>Number of Licenses Sold (Fiscal Year)</u>					
	<u>1976-77</u>	<u>1977-78</u>	<u>1978-79</u>	<u>1979-80</u>	<u>1980-81</u>	<u>1981-82</u>
In-State Distributors	15	14	14	12	12	12
Out-of-State Distributors	14	14	16	18	18	16
Producer-Distributors	12	10	10	9	11	11
Producers	292	290	294	304	293	300
Jobbers:						
(In-State Products)	47	56	66	67	74	74
(Out-of-State Products)	11	10	8	5	6	5

Source: Milk Control Bureau Records

#### Illustration 6

### Regulation of Unfair Trade Practices

The bureau's third function is enforcing rules concerning the regulation of unfair trade practices. The bureau adopted rules which prohibit the following business practices:

--selling below cost;

--accepting allowances, secret rebates, refunds, and unearned discounts;

- giving milk, dairy products, services, or article of any kind except to bona fide charities; and
- extending special prices or services that are not available to all customers who purchase milk in similar quantity under the same terms and conditions.

Bureau rules also prohibit specific types of financial involvement between, for example, a distributor and a retailer. Our review noted that the bureau had taken disciplinary action against 7 licensees for a total of 78 violations in fiscal year 1976-77. The 78 violations included 43 for providing free equipment, products, or service to retailers; 29 for extending credit beyond 15 days to retailers; and 6 for giving credit to retailers and producers. Licensees were fined a total of \$2,400. No violations have been reported or fines assessed since that time.

Also, as a means to regulate distributor compliance with the milk control laws, the bureau maintains an active investigation file which notes current violations involving unfair trade practices, illegal extension of credit to retailers, and financing prohibition violations. The audit staff updates and uses this file when reviewing distributor records. When violations are not immediately resolved, the bureau chief sends a letter of notification to the company in violation of the law indicating what steps need to be taken to be in compliance. To date, these investigations have never resulted in a license suspension or revocation.

#### Disciplinary Action

Taking disciplinary action against licensees is the bureau's fourth function. Only the bureau may decline to grant a license, or suspend or revoke a license already granted, upon due cause



and after holding hearings. The board has no authority to take disciplinary action against licensees. The bureau has declined to grant a license only once in the preceding six fiscal years, and the individual later was granted a license. No licenses were suspended or revoked during that period.

As noted previously, each producer, producer-distributor, and distributor must pay a quarterly assessment of \$.04 to \$.08 per hundredweight. By law, failure of a producer, producer-distributor, or distributor to pay the assessment to the department is a violation of the law and the individual's license automatically terminates and is void. Terminated licenses are reinstated by the bureau upon payment of a delinquency fee equal to 30 percent of the assessment which was due. From calendar year 1976 to the present, 25 fines for late assessment payments were collected by the bureau totalling approximately \$8,300. There have not been any late payments since calendar year 1978.

#### Complaints

The bureau handles all complaints concerning milk prices in the state. Complaints are received by the department by letter and by phone.

We reviewed complaint records from January 1979 to April 1982. During this period, the bureau received 46 complaints. Illustration 7 summarizes the complaints. The majority of consumer complaints concerned milk prices. Only one complaint was made against a licensee and it did not concern a violation of milk control laws. Most complaints involve consumer dissatisfaction with milk

prices and are resolved by the bureau chief sending a letter to the complainant. None of the complaints reviewed resulted in disciplinary action against licensees.

SUMMARY OF COMPLAINTS  
(Calendar Year 1979 - April 1982)

<u>Type of Complaint</u>	<u>Number</u>
Milk prices too high	33
Selling milk above price fixed by the board	1
Lack of delivery service	1
Fairer formula pricing	1
Selling milk less than minimum price	1
False advertising	1
Error in advertising milk price	2
High feed price	1
Illegible expiration date	1
Smell of dairy	1
Other	<u>3</u>
Total	46

Source: Milk Control Bureau records

Illustration 7

## Chapter III

### OTHER REGULATION

#### FEDERAL REGULATION

Two of the programs of the U.S. Department of Agriculture (USDA) affect the milk industry significantly. The Federal Milk Market Order system sets the prices paid producers for about 80 percent of the grade A milk produced in the United States. Currently, Montana is not covered by a federal milk order. The U.S. Department of Agriculture also purchases dairy products such as powdered milk and cheese in an effort to support milk prices for producers. The price support program affects all producers, including Montana's.

#### Federal Milk Market Orders

Beginning with the Agricultural Adjustment Act of 1933, the federal government was authorized to establish minimum prices for grade A milk. The original act allowed price setting at all levels, but the USDA has limited its activity to controlling producer prices. There are about 50 federal orders in effect. The orders cover more than 100,000 producers and over 1,300 distributors. The distributors are only covered in as much as the federal government checks to see that they have made the proper payments to the producers.

To get a federal order, the producers in an area must petition the federal government to institute controls. If the petition has sufficient support, the USDA will hold hearings on the proposal. Then, the USDA will decide whether sufficient evidence has been presented showing a need for controls. If so, two-thirds of the

affected producers must approve the controls at a referendum. The federal government is not likely to institute controls unless the producers can show chaos in the unregulated market.

Federal orders set prices for Class I, II, and III milk based on the Minnesota-Wisconsin price series (MW). The MW is an estimate of the prices paid by unregulated manufacturing-grade milk (primarily butter and cheese) plants in those two states. Changes in prices for manufacturing-grade milk are considered to be a good measure of changes in overall supply and demand in the dairy marketplace. The Class I price is the MW price plus an adjustment of between \$1.12 and \$3.15 per hundredweight. The size of the adjustment is based on the price needed to generate an adequate but not excessive supply of grade A milk. The price paid to producers is adjusted each month based on the movement of the MW price. The Class III price is usually the MW price; however, sometimes the price is adjusted for the costs of manufacturing. The Class II price is the MW price plus an adjustment of 10 cents to 25 cents per hundredweight.

For each individual federal order area, all producers in that area receive substantially the same price per hundredweight for their milk. This price is determined by how the milk was used by all distributors covered by the order and by the percentage of butterfat in the milk. For example, assume that the Class I, II, and III prices are \$14, \$12, and \$10 respectively. Also, assume that the usages are 40 percent, 30 percent, and 30 percent for

Classes I, II, and III. The price paid each producer (the blend price) would be:

Class I	.40 x \$14 = \$ 5.60
Class II	.30 x \$12 = \$ 3.60
Class III	.30 x \$10 = <u>\$ 3.00</u>
Blend Price	\$12.20

The prices would vary slightly from this blend price based on the butterfat content of the milk. A greater percentage of butterfat in the milk means the producer receives more money.

To equalize the financial position of distributors under an order, a settlement fund is established. The distributors pay into the fund and take out of the fund based on how their use of the milk relates to the marketwide average. Distributors with higher Class I usage than the average must pay into the fund so that distributors with lower Class I usage can use the fund to pay the blend price to producers.

To assure that the payments to the producers are proper, the USDA staff audits the use of the milk by the distributors and the payments made to the producers. Also, the staff conducts independent butterfat tests (three or four per month per producer) and compares these to the distributor's records. If there are discrepancies, the producers are paid based on the federal order tests.

The producer prices for orders in effect for some of the nearby areas are shown in Illustration 8.

MILK ORDER PRODUCER PRICES  
(May 1982)

<u>Order</u>	<u>Class I</u>	<u>Class II</u>	<u>Class III</u>	<u>Blend</u>
West Colorado	14.44	-	12.43	13.92
East Colorado	14.75	12.70	12.43	13.90
Great Basin	14.35	-	12.43	13.28
Upper Midwest	13.57	12.57	12.43	12.64
Oregon-Washington	14.40	12.68	12.43	13.39
Puget Sound	14.30	12.68	12.43	13.18
Inland Empire	14.40	12.68	12.43	13.31
SW Idaho - East Oregon	13.95	12.53	12.43	12.72
North Dakota*	13.70	12.57	11.93	12.76
Montana**	13.78	12.79	10.88	-

\*state order

\*\*Montana prices are for comparison  
No order in Montana

Source: Milk Control Bureau

Illustration 8

Dairy Price Supports

In an effort to support the prices paid to all milk producers, the USDA purchases surplus dairy products (i.e., butter, cheese, and powdered milk). These purchases influence the prices paid by the manufacturing plants for milk. Since the manufacturing price is the basis for the federal order prices and for many state order prices, the federal government purchases of dairy products influences the prices paid for almost all milk in the United States.

STATE REGULATION

In Montana, the only state agency with the authority to regulate milk prices is the Board of Milk Control. However, another state agency, the Department of Livestock, performs a

variety of milk industry regulatory functions. Some of these duties include:

- licensing milk plants and dairies selling milk or cream for public consumption;
- regulating and establishing sanitation standards for persons operating dairies producing milk for manufacturing purposes;
- enforcing laws and rules pertaining to standards of quality and sanitation of all manufactured dairy products;
- licensing all persons operating plants which manufacture dairy products;
- giving examinations to and licensing persons who conduct butterfat content tests;
- inspecting dairy and milk processing plants for sanitary conditions;
- enforcing interstate milk shipping standards; and
- establishing and enforcing milk labeling requirements.

In addition, the Department of Commerce responds to problems in the industry by cooperating with officials from the Department of Health and Environmental Sciences (control sanitary conditions of retail establishments selling milk to the public), the Board of Livestock (prevent the spread of animal disease among dairy cows), county or city boards of health (control human disease), and the Montana Department of Agriculture (pesticide contamination).

#### OTHER STATE'S REGULATION

Montana and sixteen other states regulate producer prices of milk. Between federal and state agencies, 95 percent of the grade A milk in the United States has price control at the producer level.

At the wholesale level, Montana is one of four states which regulate prices for milk. The others are Pennsylvania, North Dakota, and Maine. These four states plus Nevada regulate retail prices. Eleven states have standby authority to control wholesale prices with nine of these states having standby authority to regulate retail prices.

The following illustrations compare Montana's milk regulation to other states.

STATE REGULATION OF MILK PRICES

<u>Item</u>	<u>Montana</u>	<u>Other States</u>	
Regulate Producer Prices	Yes	16	Yes
		33	No
Regulate Wholesale Prices	Yes	3	Yes
		35	No
		11	Standby
Regulate Retail Prices	Yes	4	Yes
		36	No
		9	Standby
Sales Below Cost Statutes Specific to Milk	No*	20	Yes
		29	No
Prohibitions of Price Discrimination	Yes	14	Yes
		35	No
Price Posting Statutes	No	7	Yes
		42	No
Prohibition of Rebates, Loans, Discounts, and Gifts	Yes	20	Yes
		29	No

\*Montana has administrative rules prohibiting sales below cost.

Source: Compiled by the Office of the Legislative Auditor from publications of the International Association of Milk Control Officials and the U.S. Department of Agriculture

Illustration 9

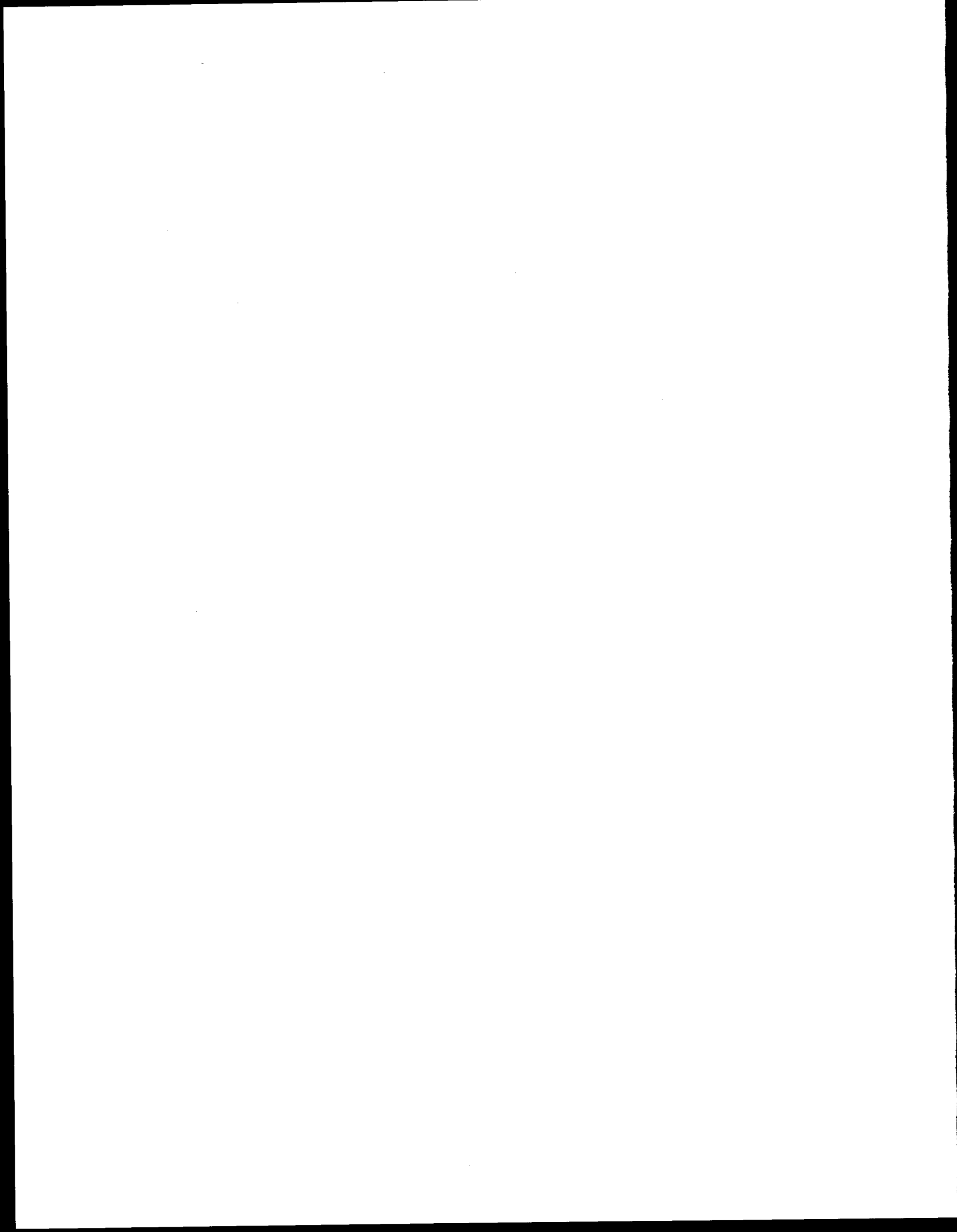


# STATE MILK PRODUCER PRICE REGULATORY AGENCIES

<u>Item</u>	<u>Montana</u>	<u>Other States</u>
Regulation by	Board of Milk Control	Milk Control Board - 10 Dept. of Agriculture - 5 Board of Agriculture - 1
Regulation Attached to	Department of Commerce	Dept. of Agriculture - 14 Independent - 2
Size of Milk Control Board	5 members	3 members - 4 5 members - 3 7 or more members - 3
Composition of Milk Control Board	All Consumers	All Consumers - 3 Mixed Consumers and Industry - 5 No Restrictions - 2

Source: Compiled by the Office of the Legislative Auditor from MCA and statutes of other states.

Illustration 10



## Chapter IV

### AREAS FOR LEGISLATIVE CONSIDERATION

In previous reviews of regulatory boards in Montana, the design and effectiveness of certain aspects of the regulatory process have warranted legislative consideration. The intent of the following sections is to briefly discuss these aspects as they apply to the Board of Milk Control. The areas for consideration are:

1. Wholesale and Retail Prices
2. Producer Prices
3. Implementing Producer Price Controls
4. Regulatory Structure
5. Butterfat Testing
6. Rate of Return
7. Fund Balance and Amount of Assessment
8. Annual License Fee
9. Need for Distributor Bond
10. Penalty for Late Assessment Payment
11. Board Member Orientation

### WHOLESALE AND RETAIL PRICES

A major function of the board is to set prices at wholesale and retail levels. The following sections discuss wholesale and retail price controls and the probable effects of decontrol.

#### Rationale of Wholesale and Retail Price Controls

Montana is one of five states which control wholesale or retail milk prices. Eleven other states have standby authority to institute wholesale price controls with nine of those also having standby

authority to regulate retail prices. In addition, two adjacent states, Wyoming and South Dakota, have recently deregulated wholesale and retail prices.

The initial rationale of controlling wholesale and retail prices was to create more stability in the market. The legislative intent section of the present statutes notes that a more stable market encourages milk production by guaranteeing adequate prices to everyone. With wholesale and retail prices controls in place, there is less incentive for distributors and retailers to destabilize the market. Wholesale price controls prevent price competition among distributors for retailers' business.

#### Probable Effects of Retail Decontrol

We attempted to determine what the effects of retail price decontrol would be in Montana. To do this, we checked retail, school, and institutional prices in surrounding decontrolled states; discussed what has happened in the surrounding decontrolled states with government officials and industry members; and discussed the possibility of retail price decontrol with Montana industry members.

We surveyed a random sample of grocery stores in Montana and in adjacent states which do not have retail price controls to determine the effects of no controls on retail prices. Appendices III and IV summarize the results of our retail grocery store survey. We found that Idaho and South Dakota had lower average prices for milk than Montana by three or four cents per half gallon. Wyoming's prices were nine cents higher per half gallon than Montana's on the average. In Montana and in the other states,

the prices tended to be lower in the larger communities and in supermarkets, and higher in small towns and convenience stores.

We surveyed school lunch programs of varying sizes in Montana and the adjacent decontrolled states. Of ten Montana schools, nine were paying the minimum state price with the tenth paying .5 cents per half pint more than the minimum. The Idaho schools, regardless of size, were generally paying lower prices with most being 1.6 to 1.7 cents per half pint lower than Montana's minimum price. In South Dakota, the school's prices were also generally lower than in Montana with most being 1 to 3 cents per half pint lower regardless of size. Wyoming's large schools paid prices .7 to 1.5 cents lower than Montana's minimum price per half pint. However, in Wyoming the medium and small schools (in number of students) were paying 2 to 3 cents more per half pint than Montana's minimum.

We also compared the prices paid by Montana institutions with the prices paid by institutions in the three adjacent decontrolled states and with the prices paid by two federal hospitals in Montana which are not subject to Montana's price controls. Montana's institutions which purchased from commercial distributors paid about the minimum price. Those which purchased from the Montana State Prison ranch pay 10 to 15 cents less per gallon than the minimum institutional price. Of the five institutions we contacted in Idaho, two were about 25 cents per gallon lower, one was 4 cents per gallon lower, and two were 30 cents per gallon higher than Montana's minimum price. The ones with the higher prices purchased small amounts of milk relative to most Montana institutions. Of five institutions we contacted in South Dakota, we found about

the same distribution as in Idaho with two substantially lower, one about the same, and two substantially higher than Montana's minimum price. We contacted eight institutions in Wyoming. Of the four which purchase substantial volumes, three were 5 to 10 cents per gallon lower than Montana's price with the fourth being at Montana's price. The other four were at Montana's price or up to 30 cents per gallon more.

The Veterans Administration hospitals in Montana pay 2 to 4 cents per half pint and 4 to 20 cents per gallon less than Montana's minimum price. These hospitals are exempt from state price control.

In summarizing our survey information, we believe Montana's experience under retail decontrol would probably be similar to Idaho's and South Dakota's and not Wyoming's. This is because Montana, Idaho, and South Dakota have an adequate supply of milk domestically, while Wyoming imports most of its milk. The price variations among cities in Montana would probably be less than the other states because Montana has more distributors, and these distributors are located in more cities throughout the state than the distributors in either Idaho or South Dakota. More distributors would result in more competition for markets and probably lower prices. Distributors in more cities should guarantee a supply of milk to all parts of the state and may lead to lower prices due to lower transportation costs.

Based upon the experience of the adjacent states without retail price controls, decontrolled retail prices in the large Montana cities, especially at the supermarkets, would likely be lower than in the small communities. Decontrolled prices in medium size cities

should be similar throughout the state with prices in small towns and at convenience stores being the highest. These changes would more nearly reflect the actual costs of providing the milk to the consumer, since it costs more per unit for handling and transportation to provide milk in a small town convenience store than it does to provide milk in a large city supermarket.

We foresee decontrol leading to some savings for school lunch programs and institutions with the large volume users receiving substantially lower milk prices. The smaller schools in rural areas may not realize a price savings.

Some changes will take place in the marketing of milk if retail prices are decontrolled. Home delivery of milk will likely decline because of the high per unit costs to deliver milk. The distributors may discontinue home delivery because high transportation costs associated with home delivery will make competition with retailers selling out of stores more difficult. Also, retailers will probably have "store brands" on their shelves which will be a few cents cheaper than the local distributor's brands. The retailers will use the prices on store brands to attract customers to the store.

Based on our review, we believe retail price decontrol would lead to lower prices to some consumers and higher prices to others. The retail prices would more accurately reflect the true costs of producing, distributing, and marketing. Retailers would have to compete for milk sales as they do on other items in their stores. Most schools and institutions would probably benefit from decontrol through lower prices. The supply of milk to consumers is not likely to be affected by decontrol of retail prices.

The quality of milk should not be adversely affected by retail price decontrol. Retailers would continue to be required to comply with the Department of Livestock's rules concerning the freshness of milk.

#### Probable Effects of Wholesale Price Decontrol

Our review also included an examination of what would happen if wholesale prices were decontrolled. We reviewed the situations in Wyoming and South Dakota which have recently decontrolled wholesale prices. We also asked the opinions of government officials and industry members in those states and in Montana.

State officials in Wyoming and South Dakota believe that wholesale price decontrol has increased competition. The number of distributors in those states has not changed significantly.

Distributors in those states are less positive about decontrol. They said decontrol has increased competition within the state and with adjacent states with milk surpluses. For example, in eastern South Dakota, distributors must now compete with distributors in Minnesota which have surplus milk to sell. Also, one distributor in northern Wyoming is facing increased competition from distributors in Montana with surplus milk to sell. Some plant managers reported reduced profitability due to price cutting caused by the increased competition. The information we have been able to gather indicates, however, that the number of distributors in the adjacent decontrolled states has not changed significantly due to decontrol.

Distributors in Montana were concerned about wholesale price decontrol. Most were concerned that they would not be able to compete with out-of-state distributors. Those Montana distributors



believe out-of-state distributors would be able to sell at low prices because they have large operations in other states which could support their operations in Montana.

The milk control bureau chief expressed the opinion that, if there was wholesale price decontrol, he would like the authority to institute temporary wholesale controls if conditions warrant. In this way, any price wars which threatened the supply of milk could be ended.

Based on our review, we do not believe decontrol of wholesale prices will affect the supply of milk to consumers. With wholesale price decontrol, retailers will attempt to meet the demand for milk and there is surplus milk in other states available to retailers in Montana. Some distributors could have difficulty competing because their equipment may not be as efficient and they may not be able to take advantage of greater efficiency associated with larger volumes. As for the quality of milk, distributors, whether in-state or out-of-state, would be required to comply with the Department of Livestock's rules for freshness.

The experience of distributors in South Dakota and Wyoming indicates that wholesale price decontrol may mean a change in some of the distribution methods for milk. Distributors may no longer stock store shelves but may drop the milk off at the store. These drop shipments would allow the distributors to offer the retailers lower prices. Stores which receive milk three or four times per week now may get milk twice a week under a decontrolled market because reducing the number of deliveries will reduce the distributor's per unit costs.

If wholesale milk prices are decontrolled, the revenue collected from distributors to pay for current regulation would not be available. To offset this loss in revenue from distributors, the producers may be required to increase their payments per hundredweight to support producer regulation.

### PRODUCER PRICES

As noted previously, one of the board's major functions is establishing the prices to be paid producers for grade A milk. The following sections address why producer controls were instituted and of what the effects of decontrol would be.

#### Rationale of Producer Price Controls

Milk producers have a different relationship to the market than do many other agricultural interests. The production rate of milk cannot be readily adjusted and fluid supplies cannot be stored to achieve a balance with demand because milk is perishable. The milk producer collects milk two or three times per day rather than every few months or once a year. In addition, milk must be stored under stringent sanitation and temperature standards. The cost of equipment to maintain the temperature and sanitation standards limits storage capacity. Therefore, the milk producer is forced to sell milk quickly or it is worth very little.

Producer price controls were initially instituted to assure adequate supplies of fresh milk. Conditions existed where producers were being offered unreasonably low prices for their milk because they had to sell within a short period of time, or lose the milk. The producer could accept the low price or refuse to sell. In both cases the producer could be forced out of business because

he lacked a proper market. The loss of the local producers jeopardized the supply of milk because it was difficult to transport fresh milk.

#### Probable Effects of Decontrol in Montana

If Montana were to decontrol producer prices at the state level, the producers in Montana would be left without price guarantees because no federal order covers Montana. Since 95 percent of the nation's grade A milk is under some type of producer price control, there is little with which to compare state decontrol. Wyoming decontrolled at the producer level in 1980. However, Wyoming's experience is probably not applicable to Montana since Wyoming is a net importer of milk and has relatively few producers. Also, many of Wyoming's producers belong to a strong cooperative which has negotiated prices similar to the surrounding federal orders.

Our discussions with government officials and industry members indicate that some Montana producers could be forced out of business if producer prices were decontrolled. They believe producers would be offered lower prices. The producers would then have the option of accepting the price offered and perhaps losing money or not accepting the price and not being able to sell their milk. The distributors would offer prices to Montana producers similar to the prices which they would have to pay to obtain milk from the surplus areas of Washington, Idaho, Minnesota, and Utah. The producers' prices in these other states are lower than Montana's. Even though prices are lower, distributors purchasing from these states would have to take into account transportation costs and

freshness. Therefore, those Montana producers who can produce at costs similar to the cost of bringing milk in from other states would remain in business. The Montana producers who have significantly higher costs for feed or whose operations are less efficient for other reasons could be forced out of business.

These same officials believe decontrol would probably not adversely affect the supply of milk to the consumer. The demand for milk would still exist and producers and distributors would meet the demand. Some of the milk, however, may not be as fresh.

In summary, it appears that producer price controls are not necessary to maintain an adequate supply of milk in Montana. However, if the Legislature wishes to keep the current level of producers in Montana then some form of producer price regulation is probably necessary.

#### IMPLEMENTING PRODUCER PRICE CONTROLS

If producer price controls continue, there are four issues related to implementing these controls. These include whether the regulation should be accomplished by the federal or state government, whether market areas should be retained, whether the state should establish uniform producer prices, and how should the prices be set. The following sections discuss these issues.

##### Federal or State Regulation

Control of producer prices can be accomplished by the state or by the federal government. State control could be in the form Montana has now. A board or agency sets minimum prices which distributors would pay producers and the state audits the distributors to assure proper payment.

The alternative to state control is a federal milk market order. Our discussions with federal officials indicate that getting a federal order is possible; however, it would probably take several years. First, Montana would have to decontrol producer prices. Then a sufficient amount of time would be needed to show chaos in the market and to mobilize the milk producers to support an order. Once the producers petition for an order, at least two years of hearings and analysis is required to develop an order. Then, two-thirds of the producers must approve the order. During the several years it would take from state decontrol to federal recontrol, some Montana producers could lose money or be forced out of business. An economist expert in milk price regulation, the bureau chief, and the former administrator of Montana's milk controls believe that producer prices would be lower and some producers would be forced out of business during the interim.

#### Marketing Areas

Section 82-23-301, MCA, states that:

"the department shall designate natural marketing areas which shall together embrace all the geographical area of the state and shall enforce minimum producer, wholesale, and retail prices established for those areas by the board."

It also requires the department to hold hearings to receive industry testimony concerning creation of marketing areas. This provision has been in the law since 1935.

The marketing areas provision was adopted when milk was produced and marketed within specific areas of the state and there was little movement of milk. The industry has changed so that there is transportation of milk between most areas of the state.

The department has reflected the change by no longer using marketing areas to establish minimum milk prices. The department has not held a hearing in 20 years to receive industry testimony in support of or opposition to creating marketing areas. Industry and board members also stated that marketing areas no longer serve a useful purpose. To maintain milk control laws that are applicable to present milk industry conditions, the legislature should consider eliminating the marketing areas provision from the law.

#### Statewide Pool

If the state continues regulating producer prices, the major concern should be to assure an adequate supply of drinking milk. To have an adequate supply of drinking milk, a small surplus of production capacity must be maintained. This surplus production capacity is necessary because demand and production vary during different seasons.

In the federal order markets, each producer shares the cost of providing the surplus capacity because all producers are paid based on how all milk is used, not just for the use of their own milk. Under the present system in Montana, producers are paid based on how the plant which receives their milk uses the milk. The producers in Montana do not share the burden of providing the surplus. An example of the effect on the producers is shown by two plants owned by the same company. One plant primarily packages drinking milk for sale throughout the whole state. The other plant packages cottage cheese for sale throughout the whole state, as well as some drinking milk. The producers which sell to

the drinking milk plant receive \$1.00 per hundred weight more for their milk than those producers selling to the cottage cheese plant.

As noted in the previous section, the board and department have abandoned the market areas in favor of statewide milk prices. Additionally, an economist expert in milk price regulation, the bureau chief, the former Montana milk control administrator, and 9 of 13 industry members we interviewed indicated that more uniformity in producer prices may be desirable. They believe more uniformity in price would encourage distributors to more efficiently market surplus milk. Also, producers would not be discriminated against simply because they are helping to supply the needed surplus. One method of achieving more uniformity is with a statewide pool, similar to that used for pricing under federal marketing orders.

In a statewide pool, all producers would receive the same uniform or blend price for their milk. The state would calculate the blend price to be paid to all producers based on the overall Class I, II, and III usage in the state and the established prices for each class of milk. This price represents the average value of milk used by all distributors in the pool. The state would inform the distributors of the prices to be paid to the producers. Therefore, each distributor pays his producers a uniform price based on how the milk is used in the state and all producers receive approximately the same amount for their milk (except for variations based on butterfat content). Under a statewide pool, some producers would receive more for their milk than they do now and some would receive less, depending on what their current prices are as compared to the blend price.

To allow for differences in milk usage, the statewide pool would establish a producer-settlement fund. This fund would be used to equalize differences in milk costs of each distributor. Distributors who use more of their milk for Class I purposes than the statewide average would pay into the settlement fund. Distributors who use less than the statewide average for Class I would withdraw money from the fund. In this way, funds may be transferred among distributors so that all distributors can pay a uniform price to the producers.

The responsibility of administering a statewide pool would rest with the milk control bureau. Their audit staff would monitor usage and payments as they do now. The bureau would also administer the settlement fund and decide who would pay into the fund and who would collect from the fund and the amount to be paid or collected.

Our review indicates that department staff and some industry members support the establishment of a statewide pool. By law, upon petition by any producer, producer-distributor, or distributor, the board is required to hold a hearing to receive evidence concerning the adoption of a statewide pooling arrangement. However, a statewide pool can only be established when it is approved in a referendum conducted by the board among the state's affected producers, producer-distributors, and distributors. The bureau chief, the former Montana milk control administrator, and 11 of 13 industry members we interviewed believe passage of such a referendum is unlikely because those who would benefit from a pool do not significantly outnumber those who would oppose a pool. Since



a pool could benefit the industry as a whole, legislative action appears to be the only practical method of establishing a statewide pool.

#### Producer Price Setting Methods

The purpose of Montana's law is to provide an adequate supply of drinking milk. The Legislature has stated the price setting formulas should consider the supply of and demand for milk, yet the present price-setting structure does not directly account for the supply of and the demand for milk in Montana.

The board has established formulas for setting the prices to be paid producers. The formula for Class I prices includes factors which address the costs of producers and indirectly the demand for milk. The Class II and III prices are related to the national prices for butter and powdered milk.

Under the current system, only the price is controlled, but the supply of milk is not. If the price is too high, the dairymen will be encouraged to produce more milk than there is a market for. Conversely, if the price is too low, not enough milk will be produced.

We compared production of grade A milk in Montana with consumption of dairy products as a whole and with consumption of whole, 2%, and skim milk in the state for the last six years. We found that production of grade A milk is growing while consumption has been relatively stable or declining. Also, drinking milk consumption is declining as a percentage of production with more milk going to the manufacture of cottage cheese, ice cream, butter, and cheese. The supply and demand information available indicates

that Montana's price may be encouraging over-production and thus may be too high. Illustration 11 summarizes our findings.

COMPARISON OF MILK PRODUCTION TO CONSUMPTION IN MONTANA

<u>Year</u>	<u>Millions of Pounds</u>			<u>Montana</u>	<u>Montana</u>
	<u>Production</u>	<u>Dairy Product</u>	<u>Montana Whole, 2% and Skim Milk Consumption</u>	<u>Per Capita Consumption of Whole, 2% &amp; Skim Milk (Pounds)</u>	
1981	291.6	187.2	175.2	222.5	60.1
1980	273.6	183.4	172.2	218.9	62.9
1979	252.0	187.2	176.2	223.4	70.0
1978	255.8	185.1	174.7	222.8	68.3
1977	246.5	185.4	174.3	226.1	70.7
1976	228.7	178.4	167.5	220.7	73.2
Percent Changes 1976 to 1981					
	+ 27.5	+ 4.9	+ 4.6	+ .9	-13.1

Source: Compiled by the Office of the Legislative Auditor

Illustration 11

We discussed this situation with an economist who consults with the federal government concerning milk price regulation. He suggested that Montana adopt a pricing method similar to the federal orders. His opinion was that basing prices on the Minnesota-Wisconsin price series (MW) would show prices reflecting supply and demand since it represents the unregulated price of milk. This view was shared by some Montana producers. However, the bureau chief, among others, objects to using the MW because he believes it does not adequately represent producer costs in Montana.

Another method would be to trigger hearings on the price formulas if production and consumption differ by more or less than a fixed percentage. At the hearings, the bureau could provide a comparison of the costs of production with the income generated

and the board could inquire into the reasons for the differences between production and consumption. In this way, the board could act to assure the proper balance between production and consumption. The board could increase price if more production is needed or decrease price if production is growing faster than consumption. A former board member suggested such a procedure but it was never adopted.

The Legislature has required that pricing consider the supply of and demand for milk. The present pricing method does not directly consider supply and demand. Alternatives to the current method include tying Montana's price to the Minnesota-Wisconsin price series or triggering review of the price formulas when production and consumption get out-of-line.

#### REGULATORY STRUCTURE

The Legislature's actions relative to the pricing mechanism for producers and to the decontrol of wholesale and retail prices will affect the regulatory structure needed. If the Legislature decontrols wholesale and retail prices, much of the board's activity would no longer exist. Basing the producer prices on the Minnesota-Wisconsin price series could further reduce its role. Also, decontrol at the wholesale and retail would focus regulation at the producer level. If the Legislature decides to substantially change price controls, we believe two alternatives to the present board structure should be considered.

One alternative would be to terminate the board and vest its authority in the Department of Commerce. In five of the sixteen other states with producer controls, producer prices are administered

by a department without a board. In those states, the departments establish producer prices, as well as administer the controls.

A second alternative would be to transfer regulation to the Department of Livestock. This would be similar to the regulatory structure in eleven of the sixteen other states with producer price controls. The Board of Livestock is composed of seven livestock owners, including a dairyman, and the board oversees all department activities. Since the Department of Livestock regulates sanitation and already has contact with producers and distributors, the Legislature could vest the department with milk price regulatory authority as well.

The Board of Livestock does not favor assuming the price control function because it would detract from their other role of promoting the livestock industry and might cause a conflict of interest. Another objection is that the transfer would give livestock a function for which they have little expertise since the department has no other price regulating function.

#### OTHER ADMINISTRATIVE ASPECTS

We also developed concerns relating to the department's administration of the milk control laws. The following sections discuss the butterfat testing program, rate of return studies, the fund balance and amount of the assessment, the amount of license fees, the need for the distributor's bond, the penalty for late payment of the assessment, and board member orientation.

##### Butterfat Testing

Current statutes require that the department establish a program to test raw milk for the purpose of determining the value

of milk supplied by producers. By law, the department may also conduct milk sampling, grading, and testing to carry out the intent of state milk control regulation.

During the 1981 legislative hearings on appropriations for the Milk Control Bureau, the Legislature discussed what agency should perform the testing and sampling function of the state's butterfat testing program. At that time, the FTE designated for butterfat testing was eliminated and the bureau was appropriated money to pay for testing to be done by the Department of Livestock. Further, the record suggests the Legislature intended that the bureau no longer collect samples of milk from producers and that the bureau limit its program functions to reviewing and compiling laboratory butterfat tests. Only the Department of Livestock has been conducting butterfat testing functions (sampling and testing) since July 1981.

The bureau has not reviewed and compiled butterfat tests, and at present, the bureau no longer performs any function of the state's butterfat testing program. There has been no coordination of Department of Livestock tests with a bureau review of tests results. Our review noted the following concerns with current butterfat testing.

#### Frequency of Testing

Butterfat tests are performed eight times per year by the Department of Livestock. To conform with accepted industry standards, tests should be performed at least once a month. At least monthly testing is necessary to allow an accurate check between the actual butterfat content and what the distributor

reports. The U.S. Department of Agriculture, under the federal orders, tests butterfat three to four times per month. Recommendations resulting from the appropriation hearings stated that the Department of Livestock should increase the number of samples it collects from eight to twelve annually per producer. The Department of Livestock has remained at eight per year because that is the minimum number of tests required for proper sanitary checks.

#### Composite Testing

At present, butterfat tests conducted by the Department of Livestock's laboratory are being done on fresh milk samples while the distributors test composite samples. A composite sample is created by combining several samples taken over a 15-day period into a single sample. Test results on composite samples, therefore, provide an average measure of the milk's butterfat content. The bureau chief noted that comparisons of processor tests on fresh milk to the tests done on composite samples yield inconclusive results. There may be a difference of one or two-tenths of a percent in butterfat which can change the dairymen's payment by 20 to 40 cents per hundredweight. To provide a more accurate measure of butterfat content and to assure that producers receive proper payment for their milk, fresh milk samples should be individually tested. The lack of an effective testing program could lead to producers being incorrectly paid for their milk.

Our discussions with department staff indicate that the bureau is in the process of amending the rules concerning composite butterfat testing. The change would require testing of a fresh sample, not a composite.

### Written Interagency Agreement

In order to clarify its role and to provide better coordination with the Department of Livestock in conducting the butterfat testing program, the bureau should develop a written agreement delineating each agency's program responsibilities. This agreement could satisfy the concerns with the frequency of testing and the use of composite samples. As part of this agreement, for example, the bureau could include a procedure whereby it would review butterfat test results and correlate them to processor tests to assure testing accuracy and proper producer payment.

### Testing by the Milk Control Bureau

As noted previously, the 1981 Legislature deleted the bureau's FTE for sampling. The Legislature also converted an FTE from an administrative position to an auditing position. The bureau recently filled this auditing vacancy and designated that this person would take producer samples as part of his duties. To have bureau staff take samples may be a violation of the intent of the Legislature as expressed in the hearing minutes and by the deletion of the former sampling position. The department believes that the discussion in the appropriation hearing is not binding.

### Rate of Return

The board is charged with establishing formulas which yield fair prices. One of the factors to be considered is "a reasonable return on investment to all ordinarily efficient and economical milk dealers." The board has not defined what is a reasonable return or what is an ordinarily efficient and economical milk dealer.

There has been little analysis of the rate of return for the milk industry in Montana. Studying producer rates of return is difficult because producers generally keep poor records and the records they do have are not standardized. For retailers, the bureau would have a difficult time segregating costs so the return on milk alone could be identified. The bureau has examined the rates of return for distributors. The last study was conducted in 1977. During that study, the bureau encountered two problems. Some distributors were reluctant to provide the information. Also, the bureau had difficulty segregating the cost of producing the non-regulated products (i.e., cottage cheese and ice cream).

With the difficulty in defining terms and in actually performing the studies, consideration should be given to eliminating rate of return as a factor to be considered in the pricing formula.

#### Fund Balance and Amount of Assessment

The board's fund balance has more than doubled in the last six fiscal years. Revenues exceeded expenditures for all of those years. Current assessments charged by the department to industry members are not commensurate with the costs of administering the milk control law, although commensurate assessments are required by the law. Board members have also expressed concern that the present fund balance is too high and exceeds the amount necessary to carry out regulation of the industry.

The bureau chief explained that one reason for having a large fund balance is to prevent cash flow problems. With the current quarterly collections, the balance needed to prevent cash flow problems is less than half of the current balance.



Since fiscal year 1975-76, there has been no change in the size of the licensee assessments. The department has the authority to amend its rules to fix the assessments at a lesser amount if it finds the costs of administering the milk control laws can be met by charging lower rates. We believe the department should reexamine its fee structure to assure that it collects only the revenue it needs to carry out regulation. Subsequent to our discussions with the department concerning this issue, the department has suspended the collection of the assessment for the second quarter of fiscal year 1982-83 in an effort to reduce the fund balance.

#### Annual License Fee

The general purpose for establishing and collecting license fees is to provide adequate revenue to cover the costs of administering the licensing law. The present license fee is deposited in the general fund and not in the Milk Control earmarked revenue account. Since all expenses are paid from the Milk Control ERA, the license fee is not being used to offset the cost of administering the license. We believe the law should be changed so the fee is deposited in the Milk Control ERA and not the general fund. Such a change would add approximately \$1,000 to the Milk Control ERA and subtract the same amount from the general fund with the present \$2 fee.

The annual license fee collected by the Department of Commerce is \$2. The \$2 license charge has not been changed since 1959. We believe the \$2 does not cover processing costs. In response to previous sunset reviews, the Legislature has allowed other boards to set fees commensurate with cost. The Legislature should consider

allowing the department to set a license fee commensurate with costs of licensing.

#### Need for Distributor Bond

Current statutes require all distributors, before purchasing milk from a producer, to deliver a surety bond to the department. The bond is intended to protect producers in case of failure by a distributor to pay a producer for milk. The present statutory minimum bond amount ranges from \$1,000 to \$5,000, based on the distributor's average daily quantity of milk purchased.

The present distributor bond requirement is outdated. It provides no means of assuring that producers will be protected in an amount that is sufficient to cover the value of the milk sold to the distributor. Industry members indicated that the present statutory bond amounts would not cover 5 percent of the value of only one producer's milk and expressed no support for the bond requirement. All distributors handle sufficient milk such that the department requires the maximum \$5,000 bond. This is a further indication that the law is obsolete. Department officials noted that the size of the bond is often less than the legal costs associated with collecting the bond. They cited cases in which a Montana Supreme Court ruling was necessary before the bond could be collected.

The small size of the bond in comparison to potential producer losses and the difficulty in collecting the bond indicate that the present bond provision is inadequate. Consideration should be given either to increasing the bond to a sufficient level or to eliminating the present bond provision from the milk control law.

### Penalty for Late Assessment Payment

The present milk control law provides that any licensee who does not pay the assessment provision automatically loses his license. He may recover the license by paying a late fee. The provision which automatically terminates a license conflicts with the Montana Administrative Procedures Act which provides for a hearing before action may be taken to revoke a license. The milk control law should be amended to make it consistent with the Administrative Procedures Act.

### Board Member Orientation

At present, newly appointed board members are performing their duties without complete understanding of their regulatory function. By law, the board is required to review complex issues which involve establishing minimum prices by means of a flexible formula, setting transportation and hauling rates, receiving and considering evidence regarding the need for a base or quota plan and considering the need for a statewide pool. Board members stated that it takes considerable time to become familiar with board regulatory duties and milk industry problems and that they received no advanced preparation before assuming their board duties. In discussions with industry members, concerns were expressed that board members lacked the expertise to provide Montana with proper milk control regulation. Department officials also stated that there is no formal training procedure to prepare board members for their duties. Member review of pertinent milk control information is voluntary.

To perform their duties most effectively, board members should have knowledge of those regulatory activities which they are statutorily required to perform. Consideration should be given to providing new members with an orientation session presented by the department. The department could also design a board member manual which would describe board duties, board statutory authority, and provide explanations about milk price regulation.

# Appendix I

## PRODUCER FORMULA

<u>Factors</u>	<u>Current Value</u>	<u>Indexed Value</u>	<u>Weights</u>
Percent unemployment - U.S.	9.4	3.13	5%
Percent unemployment - Montana	9.0	8.07	10%
Weekly wages - total private (seasonally adjusted)	264.24	35.14	15%
Prices received by Montana farmers	150.00	34.44	15%
Mixed dairy feed price	170.00	54.84	20%
Alfalfa hay price	51.03	24.49	12%
Prices paid by farmers in U.S.	155.00	65.09	23%
Index Total		<u>225.20</u>	

Source: Milk Control Bureau

<u>Formula Index</u>	<u>Price Per CWT</u>	<u>Formula Index</u>	<u>Price Per CWT</u>
161.0 - 164.6 - - - - -	\$10.79	228.5 - 232.1 - - - - -	\$14.24
165.5 - 169.1 - - - - -	\$11.02	233.0 - 236.6 - - - - -	\$14.47
170.0 - 173.6 - - - - -	\$11.25	237.5 - 241.1 - - - - -	\$14.70
174.5 - 178.1 - - - - -	\$11.48	242.0 - 245.6 - - - - -	\$14.93
179.0 - 182.6 - - - - -	\$11.71	246.5 - 250.1 - - - - -	\$15.16
183.5 - 187.1 - - - - -	\$11.94	251.0 - 254.6 - - - - -	\$15.39
188.0 - 191.6 - - - - -	\$12.17	255.5 - 259.1 - - - - -	\$15.62
192.5 - 196.1 - - - - -	\$12.40	260.0 - 263.6 - - - - -	\$15.85
197.0 - 200.6 - - - - -	\$12.63	264.5 - 268.1 - - - - -	\$16.08
201.5 - 205.1 - - - - -	\$12.86	269.0 - 272.6 - - - - -	\$16.31
206.0 - 209.6 - - - - -	\$13.09	273.5 - 277.1 - - - - -	\$16.54
210.5 - 214.1 - - - - -	\$13.32	278.0 - 281.6 - - - - -	\$16.77
215.0 - 218.6 - - - - -	\$13.55	282.5 - 286.1 - - - - -	\$17.00
219.5 - 223.1 - - - - -	\$13.78	287.0 - 290.6 - - - - -	\$17.23
224.0 - 227.6 - - - - -	\$14.01		

Source: Milk Control Bureau

## Appendix II

### WHOLESALE FORMULA

<u>Factor</u>	<u>Current Value</u>	<u>Current Index</u>	<u>Weights</u>
Weekly wages - total private (revised)	264.24	106.63	50%
Wholesale Price Index (WPI) - (U.S.)	297.90	77.66	28%
Pulp, paper, and allied products prices (U.S.)	287.90	32.90	12%
Industrial machinery prices (U.S.)	277.30	15.43	6%
Motor vehicle and equipment prices (U.S.)	246.60	9.28	4%
Index Total		<u>241.90</u>	

Source: Administrative Rules of Montana

<u>Formula Index</u>	<u>Handler Margin Increase or Decrease *</u>	<u>Formual Index</u>	<u>Handler Margin Increase or Decrease *</u>
96.00 - 100.24 . . . . .	0.00	202.00 - 206.24 . . . . .	0.20
101.30 - 105.54 . . . . .	0.01	207.30 - 211.54 . . . . .	0.21
106.60 - 110.84 . . . . .	0.02	212.60 - 216.84 . . . . .	0.22
111.90 - 116.14 . . . . .	0.03	217.90 - 222.14 . . . . .	0.23
117.20 - 121.44 . . . . .	0.04	223.20 - 227.44 . . . . .	0.24
122.50 - 126.74 . . . . .	0.05	228.50 - 232.74 . . . . .	0.25
127.80 - 132.04 . . . . .	0.06	233.80 - 238.04 . . . . .	0.26
133.10 - 137.34 . . . . .	0.07	239.10 - 243.34 . . . . .	0.27
138.40 - 142.64 . . . . .	0.08	244.40 - 248.64 . . . . .	0.28
143.70 - 147.94 . . . . .	0.09	249.70 - 253.94 . . . . .	0.29
149.00 - 153.24 . . . . .	0.10	255.00 - 259.24 . . . . .	0.30
154.30 - 158.54 . . . . .	0.11	260.30 - 264.54 . . . . .	0.31
159.60 - 163.84 . . . . .	0.12	265.60 - 269.84 . . . . .	0.32
164.90 - 169.14 . . . . .	0.13	270.90 - 275.14 . . . . .	0.33
170.20 - 174.44 . . . . .	0.14	276.20 - 280.44 . . . . .	0.34
175.50 - 179.74 . . . . .	0.15	281.50 - 285.74 . . . . .	0.35
180.80 - 185.04 . . . . .	0.16	286.80 - 291.04 . . . . .	0.36
186.10 - 190.34 . . . . .	0.17	292.10 - 296.34 . . . . .	0.37
191.40 - 195.64 . . . . .	0.18	297.40 - 301.64 . . . . .	0.38
196.70 - 200.94 . . . . .	0.19		

\*This is in addition to the \$.25 per half gallon margin in effect in November 1969.

Source: Milk Control Bureau

Appendix III

RETAIL PRICES OF HALF GALLON OF MILK IN  
MONTANA, IDAHO, SOUTH DAKOTA, AND WYOMING BY CITY SIZE  
(April 28 and 29, 1982)

City Size	Type of Milk	MONTANA			IDAHO			SOUTH DAKOTA			WYOMING		
		Average Price	Price Range		Average Price	Price Range		Average Price	Price Range		Average Price	Price Range	
Over 5,000	Whole	\$1.21	All	\$1.21	\$1.17	\$1.00	to \$1.35	\$1.14	\$ .89	to \$1.34	\$1.28	\$1.19	to \$1.49
		1.13	All	1.13	1.11	.95	to 1.35	1.09	.87	to 1.34	1.21	1.17	to 1.45
1,000 to 5,000	Whole	1.21	1.21*	to 1.25	1.19	1.01	to 1.49	1.17	1.05	to 1.32	1.28	1.10	to 1.48
		1.13	1.09*	to 1.17	1.14	.94	to 1.43	1.14	1.00	to 1.30	1.21	1.05	to 1.45
Under 1,000	Whole	1.22	1.21	to 1.40	1.21	1.04	to 1.46	1.21	1.09	to 1.30	1.34	1.05	to 1.65
		1.15	1.13	to 1.35	1.18	1.00	to 1.40	1.17	1.02	to 1.28	1.27	1.03	to 1.55
State wide	Whole	1.22	1.21*	to 1.40	1.19	1.00	to 1.49	1.18	.89	to 1.34	1.31	1.05	to 1.65
		1.14	1.09*	to 1.35	1.14	.94	to 1.43	1.13	.87	to 1.34	1.23	1.03	to 1.55

\* Below the minimum retail price.

Appendix IV

RETAIL PRICES OF HALF GALLON OF MILK IN  
MONTANA, IDAHO, SOUTH DAKOTA, AND WYOMING BY STORE TYPE  
(April 28 and 29, 1982)

Store Type	Type of Milk	MONTANA			IDAHO			SOUTH DAKOTA			WYOMING		
		Average Price	Price Range		Average Price	Price Range		Average Price	Price Range		Average Price	Price Range	
Supermarket	Whole	\$1.21	All*	\$1.21	\$1.15	\$1.00	to \$1.36	\$1.13	\$ .89	to \$1.31	\$1.23	\$1.10	to \$1.31
		1.13	1.09*	1.13	1.09	.95	to 1.35	1.09	.87	to 1.27	1.15	1.04	to 1.21
Local Grocery	Whole	1.22	1.21	to 1.40	1.20	1.05	to 1.46	1.18	1.00	to 1.28	1.32	1.05	to 1.59
		1.14	1.13	to 1.35	1.16	1.05	to 1.40	1.14	.96	to 1.28	1.24	1.03	to 1.39
Convenience Stores	Whole	1.21	1.21	to 1.26	1.21	1.01	to 1.49	1.22	1.05	to 1.34	1.36	1.19	to 1.65
		1.13	1.13	to 1.18	1.16	.94	to 1.43	1.16	1.00	to 1.32	1.30	1.15	to 1.55
Statewide	Whole	1.22	1.21*	to 1.40	1.19	1.00	to 1.49	1.18	.89	to 1.34	1.31	1.05	to 1.65
		1.14	1.09*	to 1.35	1.14	.94	to 1.43	1.13	.87	to 1.34	1.23	1.03	to 1.55

\* Below the minimum retail price.

